No. 248

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
PETITIONER

v.

LERNER STORES CORPORATION (MD.)

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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In its brief respondent attacks the constitutionality of the capital stock and excess profits taxes imposed by Sections 105 and 106 of the Revenue Act of 1935 on three grounds: (1) that Sections 105 and 106 constitute an unlawful delegation of legislative authority to the taxpayer; (2) that these sections are so arbitrary and capricious as to violate the Fifth Amendment to the Constitution; and (3) that the capital stock and excess profits taxes are "based on guesses and wagers" and that they are therefore beyond the delegated powers of Congress.

These very contentions, already advanced in at least 20 reported and about 500 unreported cases,[1] have uniformly been

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[1] Many of these suits were voluntarily dismissed by the taxpayers after this Court denied certiorari in *Allied Agents, Inc.* v. *United States*, 26 F. Supp. 98 (C. Cls.), certiorari denied, 308 U. S. 561.

rejected by the circuit courts of appeals,[2] by the Court of Claims,[3] and by the district courts; [4] there is no decision of any court to the contrary. Petitions for certiorari were filed in six of the cases decided by the Court of Claims and by the circuit courts of appeals, seeking review by this Court of the same issues as petitioner raises in this case; all the petitions were denied.[5] In addition, this Court, in *Haggar Co.* v. *Helvering*, 308 U. S. 389, discussed and construed the very sections of the Revenue Act here in issue without expressing any doubt concerning their validity. We believe that the uniform decisions

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[2] *Rochester Gas & Electric Corp.* v. *McGowan*, 115 F. (2d) 953 (C. C. A. 2); *American Viscose Corp.* v. *Rothensies*, 121 F. (2d) 186 (C. C. A. 3); *Utah Oil Refining Co.* v. *Hinckley* 121 F. (2d) 578 (C. C. A. 10); *Prime Securities Corp.* v. *United States*, 119 F. (2d) 993 (C. C. A. 6), certiorari denied October 13, 1941, Nos. 337-342, present Term; *Briggs-Darby Const. Co.* v. *Commissioner*, 119 F. (2d) 89 (C. C. A. 5). In the present case, the Second Circuit also sustained the validity of the excess profits tax on the authority of its own earlier decision in *Rochester Gas & Electric Corp.* v. *McGowan*, *supra*.

[3] *Allied Agents, Inc.* v. *United States*, 26 F. Supp. 98 (C. Cls.), certiorari denied, 308 U. S. 561; *Tennessee Consolidated Coal Co.* v. *United States*, 89 C. Cls. 542, certiorari denied, 310 U. S. 649; *Chicago Telephone Supply Co.* v. *United States*, 23 F. Supp. 471 (C. Cls.), certiorari denied, 305 U. S. 628; *Servel, Inc.* v. *United States*, 35 F. Supp. 466 (C. Cls.), certiorari denied *sub nom. General Motors Corp.* v. *United States* and *United Motors Service, Inc.* v. *United States*, 312 U. S. 708.

[4] *Rosoff Tunnel Corporation* v. *Higgins*, 28 F. Supp. 880 (S. D. N. Y.); *Midvale Paper Board Co., Inc.* v. *United States*, 31 F. Supp. 851 (S. D. N. Y.); *Mountain Iron Co.* v. *United States*, 31 F. Supp. 895 (D. Minn.); *Stromberg-Carlson Mfg. Co.* v. *McGowan*, 32 F. Supp. 101 (W. D. N. Y.); *Hornell Ice & Cold Storage Co.* v. *United States*, 32 F. Supp. 468 (W. D. N. Y.); *Isthmian S. S. Co.* v. *United States*, 33 F. Supp. 1007 (D. Del.); *Kentucky Fire Brick Co.* v. *Glenn*, 34 F. Supp. 35 (W. D. Ky.); *American Viscose Corporation* v. *Rothensies*, 34 F. Supp. 217 (E. D. Pa.); *Lake Terminal R. Co.* v. *United States*, 34 F. Supp. 963 (N. D. Ohio); *Stanolind Oil & Gas Co.* v. *Jones*, 34 F. Supp. 965 (W. D. Okla.); *United States Steel Products Co.* v. *United States*, 36 F. Supp. 368 (D. N. J.). In addition, there are innumerable District Court decisions to the same effect in which either the opinion is not reported or no opinion was rendered.

[5] *Allied Agents, Inc.* v. *United States*, certiorari denied, 308 U. S. 561; *Tennessee Consolidated Coal Co.* v. *United States*, certiorari denied, 310 U. S. 649; *Chicago Telephone Supply Co.* v. *United States*, certiorari denied, 305 U. S. 628; *General Motors Corp.* v. *United States*, certiorari denied, 312 U. S. 708; *United States Motors Service, Inc.* v. *United States*, certiorari denied, 312 U. S. 708; *Prime Securities Corporation* v. *United States*, Nos. 337-342, present Term, certiorari denied October 13, 1941.

of the lower federal courts are patently correct and that no serious argument can be made to the contrary.

1. Section 105 imposes an excise tax upon every domestic corporation of $1 for each $1000 of the adjusted declared value of its capital stock. The adjusted declared value of the capital stock for the first year is the value declared by the corporation in its first return under the section; the adjusted declared value for subsequent years is the original declared value as changed by certain prescribed capital adjustments occasioned by increases or decreases of capital occurring after the date as of which the original declared value was declared.

Section 106 imposes a graduated excess profits tax upon so much of the net income of a corporation taxable under Section 105 as is in excess of 10 per cent of the adjusted declared value of its capital stock. The adjusted declared value of the capital stock for purposes of Section 106 is "determined as provided in Section 105 as of the close of the preceding income-tax taxable year."

Respondent does not and cannot contend that Sections 105 and 106 are invalid because of the subject of the taxes which they impose; it contends only that they are invalid because they establish, as the measure of both taxes, the value declared by the taxpayer in its first capital stock return.

The legislative history of Sections 105 and 106 makes clear the purpose of Congress in providing that the value declared by the taxpayer shall be the determinative factor. As we pointed out in our brief (p. 16n.) in *Scaife Co.* v. *Helvering*, No. 57, present Term, the earlier revenue acts had imposed a tax on the capital stock of every domestic corporation measured by "the fair average value of its capital stock". Revenue Act of 1918, Section 1000 (40 Stat. 1057). This provision caused much difficulty to both taxpayers and the Commissioner, and occasioned much burdensome litigation, because it required annual appraisal of the actual value of the capital stock of every corporation. The size of the administrative burden thus placed upon the Commissioner may be appreciated when it is realized

that more than 500,000 corporations are required to file capital stock returns each year. Because of the administrative impracticability of the tax, it was repealed in 1926. See S. Rep. No. 52, 69th Cong., 1st Sess., pp. 11–12; Hearings before House Committee on Ways and Means on H. R. 1, 69th Cong., 1st Sess., pp. 700–740; see 1 Bonbright, *Valuation of Property*, pp. 577–595. When the present capital stock tax was enacted in the National Industrial Recovery Act, the Congress sought to avoid the difficulties caused by the earlier law by changing the basis of the tax from the "fair average value" of the taxpayer's capital stock to the value "declared" for its capital stock by the taxpayer itself. The value declared by the taxpayer, as we have pointed out in our brief in the *Scaife* case, is not subject to review or revision by the Commissioner or the courts and may not subsequently be amended by the taxpayer; thus a definite base for the tax is established which involves no question of valuation and cannot occasion litigation.

In order to assure that taxpayers will declare a reasonable value for their capital stock and to guard against loss of revenue through understatements of value, Congress enacted the excess profits tax as a companion to the capital stock tax and provided that the value declared by the taxpayer for capital stock tax purposes should likewise be the basis upon which the excess profits tax was computed. The two taxes were thus made largely self-adjusting: a low declaration of value, although decreasing the capital stock tax, increased the risk of a high excess profits tax, while a high declaration of value, although decreasing the tax on excess profits, correspondingly increased the capital stock tax. See *Haggar Co.* v. *Helvering*, 308 U. S. 389, 391–392, 394.

The relation between the two taxes is clearly set forth in the report of the Senate Finance Committee (S. Rep. No. 114, 73rd Cong., 1st Sess., p. 6):

> Section 214 provides for a new tax similar in principle to the capital stock tax which was levied from 1916 to 1926. In order to avoid controversy as to the value

> of the capital stock, the tax is imposed on the value declared by the corporation. A reasonable value is, however, assured by means of an excess-profits tax imposed by Section 215 and based on the relation of the net income of the corporation to such declared value. A value for the capital stock once having been declared, such value may not be subsequently changed except for bona fide changes in the capital structure. * * *
>
> Section 215 imposes an excess-profits tax on corporations. The primary object of this tax is to induce corporations automatically to declare a fair value for their corporate stock under section 214. The rate is 5 percent on the portion of the net income in excess of 12½ percent of the adjusted declared value of the stock of the corporation. The secondary object of the tax is to subject to a somewhat higher rate of tax abnormal profits which are out of proportion to the capital of the corporation.

See also S. Rep. No. 558, 73rd Cong., 2d Sess., pp. 6–7; Report of a Subcommittee of the House Committee on Ways and Means on the Proposed Revision of the Revenue Laws, 1938, 75th Cong., 3d Sess., p. 57.

2. This scheme of taxation is plainly not vulnerable to attack under the Fifth Amendment. It is only in rare and exceptional circumstances that the Fifth Amendment operates as a limitation upon the taxing power (*Magnano Co.* v. *Hamilton*, 292 U. S. 40, 44), and then only if the challenged statute is so arbitrary or capricious as to compel the conclusion that it does not involve an exercise of the taxing power at all but constitutes a confiscation of property. *Helvering* v. *City Bank Co.*, 296 U. S. 85, 90; *Nichols* v. *Coolidge*, 274 U. S. 531. Unlike the Fourteenth Amendment, the Fifth Amendment contains no equal protection clause. While it is true that the due process clause and the equal protection clause may, within certain limits, be co-extensive, it is equally true that the equal protection clause has an independent sphere of action. It is within that

independent sphere that such questions as uniformity, other than the territorial uniformity required by Article I, Section 8, fall. This must have been the analysis of this Court when it declared through Mr. Justice Holmes in *La Belle Iron Works* v. *United States*, 256 U. S. 377, 392:

> The Fifth Amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by Art. I, § 8. * * *

See also *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 583–585; *Quong Wing* v. *Kirkendall*, 223 U. S. 59, 62. Indeed, this Court has often stated, in cases involving a claim of unreasonable classification, that no Fifth Amendment question is involved. *Treat* v. *White*, 18' U. S. 264, 269; *McCray* v. *United States*, 195 U. S. 27, 61; *Billings* v. *United States*, 232 U. S. 261, 282; *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 23–24; *Barclay & Co.* v. *Edwards*, 267 U. S. 442, 450–451.

But even were we to assume that the Fifth Amendment contained a restriction upon federal taxation equivalent to that imposed upon the states by the Fourteenth Amendment, the validity of Sections 105 and 106 would be beyond question. There is no dispute that Congress could validly have taxed corporations, as it did in the earlier revenue acts, upon the basis of the actual value of their capital stock. See *Ray Copper Co.* v. *United States*, 268 U. S. 373; *Edwards* v. *Chile Copper Co.*, 270 U. S. 452; *cf. Flint* v. *Stone Tracy Co.*, 220 U. S. 107. And it is equally clear that Congress could validly have imposed an excess profits tax likewise computed upon the basis of the actual value of the corporation's capital stock. Cf. *La Belle Iron Works* v. *United States*, 256 U. S. 377. The capital stock and excess profits taxes here in issue are no different in substance. The corporations liable for the taxes are obviously best able to determine and declare the fair value of their own capital, which Congress intended that they should declare. See *Servel, Inc.* v. *United States*, 35 F. Supp. 466, 468, 469 (C. Cls.), certiorari

denied *sub nom. General Motors Corp.* v. *United States* and *United Motors Service, Inc.* v. *United States*, 312 U. S. 708; *Briggs-Darby Const. Co.* v. *Commissioner*, 119 F. (2d) 89, 91 (C. C. A. 5). If they do declare the fair value, the tax imposed upon them is precisely the same as it would have been if Congress had required such a declaration. And even if some taxpayers choose to undervalue or overvalue their capital, the fact that the capital stock and excess profits taxes are largely self-adjusting assures that the combined tax collected from all taxpayers will be reasonably uniform. The due process clause of the Fifth Amendment, if applicable at all, certainly requires nothing more. *La Belle Iron Works* v. *United States*, 256 U. S. 377, 392–393; *Briggs-Darby Const. Co.* v. *Commissioner, supra; Servel, Inc.* v. *United States, supra; Rochester Gas & Elec. Corp.* v. *McGowan*, 115 F. (2d) 953 (C. C. A. 2); *Allied Agents, Inc.* v. *United States*, 26 F. Supp. 98 (C. Cls.), certiorari denied, 308 U. S. 561; *American Viscose Corp.* v. *Rothensies*, 121 F. (2d) 186 (C. C. A. 3); *Utah Oil Refining Co.* v. *Hinckley*, 121 F. (2d) 578 (C. C. A. 10). Indeed, the administrative practicability of the present scheme of taxation, as compared with the impracticability of the former capital stock tax, may alone be sufficient to sustain its validity. *La Belle Iron Works* v. *United States, supra; Carmichael* v. *Southern Coal Co.*, 301 U. S. 495, 511, 513.

In this connection the decision of the Circuit Court of Appeals for the Second Circuit in *Rochester Gas & Elec. Corp.* v. *McGowan*, 115 F. (2d) 953, upholding the constitutionality of the capital stock tax, is particularly pertinent. The court stated (p. 955)

> In any year in which the "declared value" overshot the mark, the taxpayer would indeed pay a greater tax than it need, but only upon one-tenth of one per cent of the excess. In any year in which the "declared value" undershot it, the taxpayer would pay a tax of five per cent upon so much of the income as the "de-

clared value" did not cover. The second tax was the heavier and could in practice be reasonably insured against by a liberal allowance for "declared value", the course generally in fact adopted. To say that Congress could not choose a scheme implemented by such mild sanctions, as an alternative to actually computing an "excess profits tax" with all the uncertainty and litigation which that had involved, would be most unreasonably to circumscribe its powers to establish a convenient and flexible fiscal system.

It is true, of course, that isolated cases may occur where corporations somewhat similarly situated will pay different amounts of taxes, at least in the first or declaration year. But, as this Court has stated, the "difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation." *La Belle Iron Works* v. *United States, supra, at* 392–393. It is also true that it is difficult, if not impossible, for a corporation whose income fluctuates from year to year to declare the lowest possible capital stock valuation and still avoid excess profits taxes in any future year. But these are revenue measures and the Constitution does not require that Congress shall provide such a measure of taxation that each corporation will be enabled to declare a value which will result in the least net revenue to the Government.

The fact that the value declared for the first year is made binding for future years, with adequate adjustment for any *bona fide* change in the capital structure of the corporation, does not render the tax invalid. In view of the administrative considerations and the compensation in the operation of the excess profits tax, it can hardly be deemed arbitrary to permit the declared value to stand, subject to suitable adjustments,

at least for a short period.[6] On this aspect of the case, the decision in *La Belle Iron Works* v. *United States,* 256 U. S. 377, is conclusive. There this Court considered the excess profits tax enacted during the last war, in which invested capital was defined according to the original cost of the corporation's property rather than its present value. The validity of the tax was assailed on the ground that the statute took no account of increases or decreases in the value of the property from the time of its original acquisition, and that therefore the tax was "glaringly unequal" in its impact upon corporations which, at the time of the imposition of the tax, had property of substantially the same value. This Court rejected the contention, stating (pp. 392–393):

> Nor can we regard the act—in basing "invested capital" upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the

[6] Section 215 (f) of the National Industrial Recovery Act, Section 701 (f) of the 1934 Act, and Section 105 (f) of the 1935 Act, did not provide for any limitation of time upon the use of the original declared value. However, the passage of the later Acts operated in such fashion that a corporation was compelled to utilize the value declared for the previous year only in the returns for the years ending June 30, 1935, and June 30, 1937. Section 601 (f) of the Revenue Act of 1938, 52 Stat. 447, provides that the adjusted declared value shall be determined with respect to three-year periods beginning with the year ending June 30, 1938, and each third year thereafter.

propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation.

Respondent's suggestion (Br. 16–20) that the tax operates unfairly against many taxpayers because of the ending dates of their fiscal years is without substance. As we have pointed out, the purpose of Congress was to induce taxpayers to declare the fair value of their capital stock; determination of such fair value at any particular time obviously does not depend upon the fiscal period employed by the taxpayer. It is true that a corporation with a fiscal year ending June 30 may, instead of declaring the fair value of its capital, state a higher value which will enable it to avoid the excess profits tax for the first or declaration year, while a taxpayer, such as respondent, whose fiscal year ends on January 31, cannot with equal assurance compute the figure which will enable it to pay the lowest combined tax for the first year. But the apparent advantage which the first corporation may have for the declaration year is very apt to disappear in subsequent years when, by reason of its overstatement of capital, it must pay a higher capital stock tax than it would have had to pay if it had declared the fair value, and when its earnings are such that it would not have had to pay any excess profits tax on the basis of fair value. In any event, the fact that minor discrepancies may occur in isolated cases where the taxpayer has overvalued or undervalued its capital and where the operation of the capital stock and excess profits taxes may not be entirely successful in assuring the imposition of a combined tax reasonably equivalent to that which would have been *imposed* had a fair value been declared, is surely not sufficient ground for condemning the entire scheme of taxation as so arbitrary and capricious as to constitute a taking of property without due process. As the Court of Claims stated in *Allied Agents, Inc.* v. *United States*, 26 F. Supp. 98, certiorari denied, 308 U. S.

561, a leading case upholding the validity of the capital stock tax (p. 102):

> There are many taxes as to which hypothetical cases can be made up which will present, as between taxpayers, a strong discrimination; but in actual practice the two taxes under consideration are much more likely to work out fairly and with less discrimination than the old excess-profits tax which seldom if ever operated without [illegible] more or less discrimination and often compelled one taxpayer having the same amount of profits as another to pay many times more taxes than a competitor which was using no greater amount of capital.

3. Respondent's contention that the taxes are unconstitutional because based on "guesses and wagers" (Br. 20–22) merits no extended discussion. As we have pointed out, the purpose of Congress was to assure a fair declaration of value, and to that end it allowed the taxpayer, which is in the best position to ascertain such value, to make its own declaration. In order to avoid administrative difficulties, Congress made the taxpayer's declaration conclusive, using the device of the excess profits tax in place of revision by the Commissioner and the courts to guard against understatements of value. But plainly, as the lower federal courts have uniformly held, the fact that taxpayers may, if they choose, declare an arbitrary figure, rather than the fair value of their capital, in an attempt to secure the lowest possible combined tax, does not mean that the tax is based on a "guess". The taxpayer is not required to guess at anything; it may, as Congress intended it should, declare the fair value of the capital stock. If it does make a guess, it is only in trying so to fix the value that it will result in paying the lowest possible combined tax. See *Servel, Inc.* v. *United States*, 35 F. Supp. 466, 468 (C. Cls.), certiorari denied *sub nom. General Motors Corp.* v. *United States* and *United Motors Service, Inc.* v. *United States*, 312 U. S. 708; *Allied Agents, Inc.* v. *United States*, *supra*, at 103–104. Manifestly, the employment

of this administratively practicable device does not deprive the statute of its character as a revenue act and thus place it beyond the delegated powers of Congress.

4. There is likewise no substance to respondent's contention (Br. 12–15) that Sections 105 and 106 are invalid because delegating legislative power to the taxpayers. As pointed out in the *Allied Agents* case, *supra*, at 103, "nothing that the taxpayer does or can do affects anyone but itself. The corporation performs no legislative duty in making the election or choice of the amount which it will declare * * *." Nor can it be said that Congress has provided no legislative standard; the statute specifically prescribes the method by which both taxes are to be computed, the taxpayer simply being given an option in declaring the amount which forms the basis of the computation. See *Rochester Gas & Elec. Corp.* v. *McGowan, supra; American Viscose Corp.* v. *Rothensies, supra; Utah Oil & Refining Co.* v. *Hinckley, supra.*

It is true, of course, that the particular value which the taxpayer declares affects in some measure the combined capital stock and excess profits tax which it must pay; indeed, by declaring no value for its capital or by grossly overvaluing its capital, it may entirely avoid one or the other of the two taxes. But this is a frequent result of tax provisions, the validity of which is universally conceded. Thus, taxpayers may elect either the cash or accrual basis of accounting; their selection between the two may in any particular year, and even over the course of years, have a very decided effect upon their tax liability. The election given to taxpayers to choose between cost and percentage depletion is another familiar example. And, of course, taxpayers may, and constantly do, affect the amount of their tax liability by selling capital assets at particular times selected with an eye to tax advantages. As these examples demonstrate, it is immaterial that the particular value chosen by the taxpayer may have some effect upon its tax liability for a particular year; the decisive consideration is that, by the combined operation of both capital stock and excess profits taxes,

Congress has assured that, except in very unusual or extraordinary circumstances, all taxpayers, whatever value they may declare, will bear a reasonably equivalent tax burden. This being so, the act of the taxpayer in declaring the value of its capital stock cannot in any possible sense be deemed the exercise of a legislative power delegated to it by Congress.

Respectfully submitted,

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